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SUBJECT: ESTONIA'S PROPOSED 2010 BUDGET SPURS LITTLE DEBATE

¶1. (SBU) SUMMARY: Estonia's 2010 budget quietly sailed through the first reading in the parliament - a surprising development given the 14 percent drop in GDP this year and the contentious budget debates of previous years. This might be a calm before the storm as the opposition parties are starting to recover from the local elections on October 18 and pay increasingly more attention to state budget issues. The GOE's primary political-economic goal remains to join the Euro zone in 2011. Therefore, all effort has been put to meeting the Maastricht criteria of a budget deficit less than three percent of GDP. To achieve this, the 2009 budget was trimmed twice this year (and will likely need to be cut again), and 2010 spending is set to remain at 2009 levels. Additionally, the GOE has searched for methods to boost revenue in both budget years. END SUMMARY.

Trimming Expenses And Trying to raise revenue

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¶2. (U) The 2010 budget, which had its first reading in the Parliament on October 21, reflects Estonia's difficult economic situation. When planning the 2010 budget, the Ministry of Finance used GDP growth forecasts of -14.5 percent in 2009 and -0.1 percent in 2010. Accordingly, planned expenditures for next year total EEK 89.6 billion (USD 8.5 billion) which is almost the same level as in 2009 (EEK 89.3 billion). State revenues are not expected to exceed EEK 84 billion, so this proposal would meet the Maastricht budget criteria with a budget deficit of 2.95 percent of GDP. However on October 26, a visiting IMF delegation suggested the GOE should cut an additional one percent of GDP from the 2010 budget to ensure it remained on course for Euro accession. The IMF also recommended Estonia carry out additional structural reforms to its tax and social benefits systems since the impact of short-term measures to improve the 2009 budget will evaporate by 2011 and revenues will not reach pre-crisis levels in the near future.

¶3. (SBU) The GOE has cut the 2009 budget twice since it was passed and many analysts expect a third round of cuts before the end of the year. The first cut was in February, when expected state revenues were lowered by 9.8 percent from EEK 97.8 billion to EEK 88.2 billion (USD 9.26 billion to 8.35 billion) and state expenditures by 6.8 percent from EEK 98.5 billion to EEK 91.8 billion (USD 9.33 billion to 8.69 billion). The main savings came from a reduced increase in pension payments (5 percent instead of 14 percent) and from cutting all state salaries by eight percent.

14. (SBU) Although it was apparent in March-April that further budget cuts were needed, the GOE waited until after the June EU Parliament elections to make a decision on the second round of cuts. In June the GOE decided to make another 3.5 percent cut in expected revenues and 2.8 percent cut in expenditures. This time the primary changes included increasing the VAT from 18 percent to 20 percent and decreasing the responsibilities of the Estonian Health Insurance Fund.

15. (U) Although nominal defense spending decreased in 2009, the GOE is committed to holding defense spending at 1.86 percent of GDP (septel) in 2010, close to the NATO target of 2 percent. Additionally, the GOE has so far kept its pledge to not cut pensions (although they will not rise in 2010) or change the generous system of benefits to new parents. The GOE will continue to cut operating expenses in 2010, to a level lower than in 2007. The GOE started layoffs and the elimination of unfilled positions early in 2009 (the MFA, for example, laid-off 18 diplomats October 23). More than half of the ministries have said that they are planning to continue cutting jobs in 2010, and reducing salaries by an additional 4.7, for total wage cuts of 12.7 percent.

16. (U) Increasing tax debts is a growing concern for the Estonian Tax Board. At the end of September, taxpayers in Estonia owed EEK 6.1 billion (USD 577 million) in unpaid taxes, over half a billion

EEK more than at the end of the second quarter. To make up for some of the lost revenue, the GOE will continue selling government property, primarily land owned by the Ministry of Interior and Ministry of Environment, and will increase the alcohol excise duty by 10 percent as of 1 January 2010. The tobacco excise duty will also increase, by 20 percent, but not until 1 January 2011.

#### EU STRUCTURAL FUNDS

17. (U) The GOE budget will be buoyed in 2010 by a 15 percent increase in EU structural funds. The total EU support in the budget bill is EEK 14.5 billion (USD 1.37 billion, or 16 percent of the budget). The government's priority is to use EU support to stimulate the economy, increase employment and make investments in education and the environment.

#### Impact on state-owned enterprises

18. (U) The GOE decided at the end of August to take EEK 1.7 billion (USD 161 million) in additional dividends from the state-owned companies Eesti Energia (Estonian Energy) and the Port of Tallinn to help reduce the budget deficit. Eesti Energia did not object to the extra dividends, but officials from the Port of Tallinn complained publicly about the effect it would have on planned port expansions. The Port of Tallinn paid a dividend of EEK 30 million (USD 2.8 million) earlier this year, and was instructed to pay another EEK 386.6 million (USD 36.6 million) by the end of November. However, on October 29 the GOE approved a 15-year, EUR 50 million (USD 74.15 million) loan to fund the port's expansion plans. The GOE is planning to take dividends of similar size from the port and Eesti Energia in 2010. Additionally, the GOE is considering privatizing part of Eesti Energia to raise money for clean energy investments.

## Surprisingly Calm Budgeting

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¶9. (SBU) Given the severe economic picture and two sets of elections (EU and local) in 2009, there has been a surprising lack of criticism and debate so far since the proposed budget was unveiled in September. During the recent economic boom and more recent series of budget cuts, there was significant debate and criticism over the GOE's budget decisions as soon as the budget figures were made public. However, the 2010 budget was not a prominent issue in the October 18 municipal elections. Opposition parties publicly said they would support the proposed budget, even while complaining about it privately to Emboffs.

¶10. (SBU) Almost two weeks after the local elections, the opposition parties are starting to make demands. On October 29, these parties presented a list of amendments to the budget, such as: to decrease the VAT on heat from 20 percent to 9 percent, increase the percentage of income tax going to local governments, increase support to agriculture, and increase the living allowances for the underinsured. The Green Party asked for more financing for energy efficiency projects and the Social Democrats suggested equating defense and cultural spending. All proposed changes have to be submitted to the Parliament by November 4, but so far this round of budgeting has been surprisingly quiet.

¶11. (SBU) The GOE continues to make painful cuts in the hopes of keeping the 2009 budget deficit below three percent of GDP, in

order to maintain Euro eligibility. Despite these measures, it is unlikely we will learn whether or not they were successful until well into 2010 and the margin of success or failure will be very slim. Any downward revision of growth will cause further painful cuts.

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